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No. ———

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

DALLAS C. BROWN, JR., *et al.*,
Petitioners,

v.

JAMES H. PAIGE, III, State Tax Commissioner
of the State of West Virginia,
Respondent.

Petition for Writ of Certiorari to the Supreme Court of Appeals of West Virginia

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PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Whether the discriminatory income taxation scheme of West Virginia, as it relates to the taxation of the retirement pay of military retirees compared to that of retired state and local police and firefighters, in order to be upheld, must be justified by, and directly related to, significant differences between the two groups other than the source of pay.

II. Whether there exists an insubstantiality exception to the prohibition of discrimination contained in 4 U.S.C. § 111 and the Intergovernmental Tax Immunity Doctrine, which would permit some extent of discrimination because of source of pay.

III. Whether discrimination because of source of pay violates 4 U.S.C. § 111 and the Intergovernmental Tax Immunity Doctrine only if the taxing authority is shown to affirmatively intend, through implementation of a calculated scheme or plan, to discriminate against federal retirees.

IV. Whether significant differences between military retirees and retired state and local police and firefighters, other than the sources of their pay, have been established which justify and directly relate to the discriminatory West Virginia income tax scheme.

PARTIES TO THE PROCEEDINGS

The following persons were Appellees in the court below in the case of *Brown v. Mierke*, 443 S.E.2d 462 (W.Va. 1994):

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The Appellant in the court below in the case of *Brown v. Mierke*, 443 S.E.2d 462 (W.Va. 1994), was Alan L. Mierke, then Acting State Tax Commissioner of the State of West Virginia. Mr. Mierke has since left such office, and the successor in office to Mr. Mierke is James H. Paige, III, State Tax Commissioner of the State of West Virginia. Consequently, Mr. Paige, in such official capacity, is the Respondent in this proceeding.

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Respondent.

Petition for Writ of Certiorari to the Supreme Court of Appeals of West Virginia

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PETITION FOR WRIT OF CERTIORARI

The Petitioners respectfully pray that a writ of certiorari issue to review the judgment of the Supreme Court of Appeals of West Virginia, entered in the above-entitled proceeding on March 24, 1994.

OPINIONS BELOW

The opinion of the Supreme Court of Appeals of West Virginia is officially reported at *Brown v. Mierke*, 443 S.E.2d 462 (W.Va. 1994), and is reprinted in the Appendices at pp. 1a-13a. The ruling of the Circuit Court of Kanawha County, West Virginia on the parties' cross motions for summary judgment is not officially reported, and is reprinted in the Appendices at pp. 14a-25a. The ruling of the Supreme Court of Appeals of West Virginia on the Petitioners' petition for rehearing is not officially reported, and is reprinted in the Appendices at p. 26a.

STATEMENT OF JURISDICTION

The Supreme Court of Appeals of West Virginia entered the judgment in this matter on March 24, 1994. A timely petition for rehearing was filed by the Petitioners on April 22, 1994. The Supreme Court of Appeals of West Virginia entered the order denying such petition on May 5, 1994. Jurisdiction of this Court to review the judgment in question is invoked under 28 U.S.C. § 1257 (a) (1993).

STATUTES INVOLVED

4 U.S.C. § 111 (1993) provides:

> The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States, a territory or possession or political subdivision thereof, the government of the District of Columbia, or an agency or instrumentality of one or more of the foregoing, by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

W.VA. CODE § 11-21-12(a) (1991 & Supp. 1994) provides:

> (a) *General.*—The West Virginia adjusted gross income of a resident individual means his federal adjusted gross income as defined in the laws of the United States for the taxable year with the modifications specified in this section. (1993, c. 156)

W.VA CODE § 11-21-12(c)(5) (1991 & Supp. 1994) is reproduced in the Appendices at p. 27a.

W.VA. CODE § 11-21-12(c)(6) (1991 & Supp. 1994) is reproduced in the Appendices at p. 28a.

STATEMENT OF THE CASE

This action was commenced in the Circuit Court of Kanawha County, West Virginia (hereinafter "the circuit court") on September 13, 1990, by Dallas C. Brown, Jr., et al. (hereinafter "the Petitioners"). Each of the Petitioners is a retired officer or enlisted person of one of the branches of the United States Armed Forces, and each currently receives military retirement pay. The Petitioners sought in the circuit court a declaratory judgment stating that the tax scheme set forth in W.VA. CODE § 11-21-12 (1991 & Supp. 1994), as it relates to the taxation of retirement pay received by former state, local and federal government employees, violates the Intergovernmental Tax Immunity Doctrine and 4 U.S.C. § 111.[1]

Military retirement pay is included in gross income for purposes of the federal income tax, and is thus, a component of federal adjusted gross income. 26 U.S.C. § 61(a)(11) (1984). For purposes of the West Virginia personal income tax, a taxpayer's West Virginia adjusted gross income is equal to his or her federal adjusted gross income, increased or decreased by statutory modifications, W.VA. CODE § 11-21-12(a). The first $2,000 of any retirement pay received from a military retirement system is deducted from federal adjusted gross income to arrive at West Virginia adjusted gross income. W.VA. CODE § 11-21-12(c)(5). In comparison, the entire amount of retirement pay received from any West Virginia municipal police retirement system, West Virginia municipal firemen's retirement system or from the West Virginia Department of Public Safety, Death, Disability and Retirement Fund, is deducted from federal adjusted gross income to arrive at West Virginia adjusted gross income.[2] W.VA. CODE § 11-21-12(c)(6).

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[1] As this case only involves entitlement to declaratory relief, it does not directly present the question of the refund of taxes paid under the challenged tax scheme.

[2] Under West Virginia's income tax, any taxpayer, including a military retiree or a retired state or local police or firefighter, who

Because retirement pay received from a military retirement system, to the extent it exceeds $2,000, is not deducted from federal adjusted gross income, it is subject to the West Virginia personal income tax. W.VA. CODE § 11-21-3(a)(1) (1991). Because retirement pay received from a West Virginia police or firefighters' retirement system, or from the West Virginia Department of Public Safety, Death, Disability and Retirement Fund, is deducted in full from federal adjusted gross income, it is not subject to the West Virginia personal income tax. *Id.*

Ruling on cross motions for summary judgment with respect to the prayer of the Petitioners for declaratory judgment, the circuit court followed this Court's decisions in *Davis v. Michigan*, 489 U.S. 803 (1989), and *Barker v. Kansas*, 503 U.S. ——, 118 L.Ed.2d 243 (1992), and found for the Petitioners, declaring that the tax scheme embodied in W.VA. CODE §§ 11-21-12(c)(5) and (6) violates the doctrine of intergovernmental tax immunity and 4 U.S.C. § 111. (App. 24a). The Respondent petitioned for appeal to the Supreme Court of Appeals of West Virginia, (hereinafter "the court below"), assigning as error the declarations of the circuit court that the discriminatory tax scheme is based solely on source of pay, and that the disparate tax treatment is not justified by or directly related to other significant differences. The court below granted the appeal and reversed the circuit court, holding that the doctrine of intergovernmental tax immunity and 4 U.S.C. § 111 were not violated, and that such federal authorities were not even implicated. (App. 12a). The Petitioners requested a discretionary rehearing by the court below, which was denied. (App. 26a).

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is permanently and totally disabled or who has attained the age of 65, is entitled to a decreasing modification, reducing federal adjusted gross income, in the amount of $8,000, less any decreasing modification permitted by W.VA. CODE §§ 11-21-12(c)(1), (2), (5) and (6) (1991 & Supp. 1994). W.VA. CODE § 11-21-12(c)(7) (1991 & Supp. 1994).

REASONS FOR GRANTING THE WRIT

The special and important reasons for grant of this Writ of Certiorari are that the holding below: (1) conflicts with this Court's decisions in *Davis* and *Barker*; (2) conflicts with the decisions of other state courts of last resort, including *Kuhn v. Department of Revenue of State of Colorado*, 817 P.2d 101 (Colo. 1991); *Pledger v. Bosnick*, 811 S.W.2d 286 (Ark. 1991), *cert. denied*, 125 L.Ed.2d 721 (1993); and *Hackman v. Director of Revenue*, 771 S.W.2d 77 (Mo. 1989), *cert. denied*, 493 U.S. 1019 (1990); (3) conflicts with the decision of the United States Court of Appeals, Fourth Circuit in *United States v. City of Manassas, Virginia*, 830 F.2d 530 (4th Cir. 1987), *aff'd* 485 U.S. 1017 (1989), concerning a federal question; (4) improperly applies and extends this Court's decision in *Department of Revenue v. ACF Indus., Inc.*, 510 U.S. ——, 127 L.Ed.2d 165 (1994); and (5) errs in upholding the West Virginia statute despite being challenged under the Constitution and federal law.

The court below failed to apply the legal analysis and standards developed by this Court in *Davis* and *Barker* under the doctrine of intergovernmental tax immunity and 4 U.S.C. § 111. Instead, the court below relied on this Court's holding in *ACF*, which is inapplicable to the question of the constitutionality and lawfulness of the challnged tax scheme. By relying on *ACF*, the court below has created exceptions to the prohibition of discrimination based on source of pay found in 4 U.S.C. § 111 and the Intergovernmental Tax Immunity Doctrine, which, if allowed to stand, will undermine the very purpose of the doctrine. These exceptions also directly conflict with the decision in *City of Manassas*.

This Court should grant certiorari in order that it may reverse the decision below and affirm the principle that discrimination against federal retirees, which is based on the source of their pay, is absolutely prohibited by the Intergovernmental Tax Immunity Doctrine and 4 U.S.C.

§ 111, regardless of the scope or extent of that discrimination. Moreover, in order to sustain the continued viability of that principle, this Court should expressly overrule the holding of the court below, insofar as it requires a showing of anti-federal intent as a prerequisite to scrutiny of discrimination in fact under 4 U.S.C. § 111 and the doctrine.

I. WEST VIRGINIA'S DISCRIMINATORY INCOME TAX SCHEME, AS IT RELATES TO TAXATION OF THE RETIREMENT PAY OF MILITARY RETIREES COMPARED TO THAT OF RETIRED STATE AND LOCAL POLICE AND FIREFIGHTERS, MUST BE JUSTIFIED BY AND DIRECTLY RELATED TO SIGNIFICANT DIFFERENCES BETWEEN THE TWO GROUPS OTHER THAN THE SOURCES OF THEIR PAY.

A. The Intergovernmental Tax Immunity Doctrine And 4 U.S.C. § 111, As Applied In *Davis* And *Barker*, Control The Disposition Of This Case.

The general principles of the Intergovernmental Tax Immunity Doctrine have been codified in 4 U.S.C. § 111, which permits a state to tax the compensation of federal employees, provided that the state does not discriminate against them based on the source of their pay. This statutory nondiscrimination rule "closely parallels" and is "coextensive with" the doctrine which forbids a state to "discriminate against the [Federal] Government or those with whom it deals." *Davis*, 489 U.S. at 812-13 (quoting *United States v. City of Detroit*, 355 U.S. 466, 473 (1958)).

This Court has issued two decisions regarding the interpretation and application of the aforementioned doctrine and 4 U.S.C. § 111 in the context of state income taxation of the retirement pay of federal retirees. In *Davis*, this Court held that the prohibition of discrimination based on source of pay, found in 4 U.S.C. § 111, applies to retirement compensation. *Davis*, 489 U.S. at 808. After analyzing the development of the modern doctrine of inter-

governmental tax immunity, and the language of 4 U.S.C. § 111, this Court held that "the relevant inquiry is whether the inconsistent tax treatment is directly related to and justified by, 'significant differences between the two classes.'" Id. at 816 (quoting *Phillips Chem. Co. v. Dumas Indep. Sch. Dist.*, 361 U.S. 376, 383 (1960). The taxpayer in *Davis* was a former United States Government employee who received federal civil service retirement pay. The Michigan income tax statutes defined taxable income in a manner such that the retirement pay of retired state employees was exempt, while the retirement pay of retired federal employees was not. *Davis*, 489 U.S. at 806.

The taxpayers in *Barker* were military retirees who received federal military retirement pay. The State of Kansas taxed such pay, but did not tax the comparable retirement pay received by retired state and local government employees. *Barker*, 503 U.S. at ——, 118 L.Ed.2d at 248. This Court held that, for purposes of 4 U.S.C. § 111, military retirement pay is deferred compensation for past services, not reduced pay for current services. *Id.* at ——, 118 L.Ed.2d at 254. Thus, the prohibition of discrimination based on source of pay found in 4 U.S.C. § 111, as applied in *Davis*, controlled the disposition of *Barker*. *Id.* at ——, 118 L.Ed.2d at 249. Consequently, this Court stated that, "[u]nder [the Intergovernmental Tax Immunity Doctrine], we evaluate a state tax that is alleged to discriminate against federal employees in favor of state employees by inquiring 'whether the inconsistent tax treatment is directly related to, and justified by, 'significant differences between the two classes.'" *Barker*, 503 U.S. at ——, 118 L.Ed.2d at 249 (quoting *Davis*, 489 U.S. at 816 (quoting *Phillips*, 361 U.S. at 383.)).

Once discrimination in fact between a group of federal and a group of state or local retirees is shown to exist, the disparate tax treatment will be permitted only if justified by and directly related to other significant differences between the two groups. *Davis*, 489 U.S. at 813; *Barker*,

503 U.S. at ——, 118 L.Ed.2d at 249. In cases such as the present case, where actual tax discrimination against federal employees or retirees exists,[3] there is no prerequisite to the application of the nondiscrimination rule of 4 U.S.C. § 111 and the Intergovernmental Tax Immunity Doctrine. This must be particularly so where, as here, the challenged tax statutes expressly classify retirees solely by reference to the sources of their retirement pay. Source-dependent classifications cannot be excused from scrutiny under *Davis* and *Barker*, by either a lack of affirmative intent to burden federal retirees or the limited number of state retirees favorably affected by such discrimination.

The court below recognized the disparity between the state income tax treatment of the retirement pay of military personnel *vis-a-vis* state and local police and firefighters. (App. 2a-3a). However, it refused to apply the analysis for judging the legality of such discrimination mandated by this Court in *Davis* and *Barker*, because it found that the extent of the discrimination based on source of pay was not so great as to be objectionable, and because it found an absence of anti-federal intent. However, upon examination, it is clear that the West Virginia tax scheme suffers from materially the same constitutional infirmities as did the Michigan and Kansas tax schemes. Only the extent of the discrimination is less in the present case because the number of state and local retirees favored by the discrimination is proportionately smaller.

To determine whether a tax scheme violates the statutory and constitutional prohibition of discrimination because of source of pay, a reviewing court must consider "how other taxpayers similarly situated are treated" by "examination of the whole tax structure of the state", and must "focus on the nature of the classification[s] erected"

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[3] *See, Washington v. United States*, 460 U.S. 536, 544-45 (1983) ("The State . . . discriminate[s] against the Federal government and those with whom it deals . . . [when] it treats someone else better than it treats them.").

by statute. *Phillips*, 361 U.S. at 383 (quoting *Tradesmens Nat. Bank v. Oklahoma Tax Comm.*, 309 U.S. 560, 568 (1940)). In the context of the Intergovernmental Tax Immunity Doctrine and 4 U.S.C. § 111, the taxpayers similarly situated to the Petitioners, the taxation of which must be compared, are all public sector retirees. This follows from the fact that private sector retirees are not protected by the doctrine, and the plain language of 4 U.S.C. § 111 which makes it clear that all public sector retirees are to be treated as similarly situated. The fact that all individuals within the class of public sector retirees are entitled to government retirement pay, due to some period of active public service, is sufficient to render them similarly situated, and to presume that they should be "taxed alike". *Phillips*, 361 U.S. at 381.[4]

The court below, however, erroneously treated the threshold question, of whether retired state and local police and firefighters are similarly situated to military retirees, as supplanting the ultimate question of whether there exists other significant differences which directly relate to and justify the disparate tax treatment. The court below then compounded its error by implying that such groups are not similarly situated because the Petitioners failed to establish that the job descriptions of one group were consistent with the job descriptions of the other group. (App. 11a). This approach helped the court below to side-step altogether this Court's holding's in *Davis* and *Barker*. However, this Court has not required taxpayers, challenging similar discriminatory tax schemes, to show that the job descriptions of public sector retirees are identical or even similar in order to compare the tax treatment of their retirement pay. *Davis*, 489 U.S. at 815-16; *Barker*, 503 U.S. at ——, 118 L.Ed.2d at 249-50. This Court must not allow such direct disregard of its prece-

[4] In *Phillips*, the members of the class deemed similarly situated had in common simply that "they use exempt property for a non-exempt purpose . . . and presumably should be taxed alike." *Phillips*, 361 U.S. at 381.

dents to sustain the impermissible discrimination in this case.

B. The *ACF* Case Is Neither Controlling Nor Persuasive Because It Does Not Involve The Application Of The Intergovernmental Tax Immunity Doctrine Or 4 U.S.C. § 111.

After quoting extensively from *Davis*, Justice Richard Neely, writing for the court below, nevertheless, found that the precedent which controlled the disposition of the present case was neither *Davis* nor *Barker*. (App. 7a). Instead, the court below "grounded" its decision on the *ACF* case. (App. 10a). However, upon examination, it is clear that *ACF* has no legitimate bearing upon the disposition of the present case, and the court below erred in relying upon it to uphold the discriminatory West Virginia tax scheme. Rather, *ACF* is concerned only with the interpretation of one section of the Railroad Revitalization and Regulatory Reform Act of 1976, 49 U.S.C. § 11503 (1979), (hereinafter the "4-R Act"), specifically, 49 U.S.C. § 11503(b)(4) (1979). *ACF* is clearly not a part of this Court's precedent in the area of intergovernmental tax immunity, or application of 4 U.S.C. § 111. The issue presented in *ACF* was "whether the State of Oregon violated [49 U.S.C. § 11503(b)(4)] by imposing an *ad valorem* tax upon railroad property while exempting various other, but not all, classes of commercial and industrial property." *ACF*, 510 U.S. at ——, 127 L.Ed.2d at 170. This Court held in *ACF*, "that a state may grant exemptions from a generally applicable ad valorem property tax without subjecting the taxation of railroad property to challenge *under the relevant provisions of the 4-R Act*, Section 306(1)(d), 49 U.S.C. § 11503(b)(4)." *Id.* at ——, 127 L.Ed.2d at 170 (emphasis added).

The court below erroneously extended this holding in finding that a state may grant exemptions from a generally applicable income tax, to persons in privity with it,

without subjecting the resulting disparate tax treatment to challenge under the Intergovernmental Tax Immunity Doctrine and 4 U.S.C. § 111. The court below emphasized that the discrimination in *ACF* was limited insofar as the favorable tax treatment was granted to a relatively small class. Finding that "the facts of the railroad car case [*ACF*] are far closer to the case before us than to either *Davis* or *Barker*," (App. 11a), the court below was distracted by the perceived factual similarity and relied on this Court's interpretation of a section of the 4-R Act to effectively avoid the principles laid down in *Davis* and *Barker*. The *ACF* holding cannot be applied so broadly.

Perhaps recognizing the narrow scope of that decision, the court below acknowledged that its reliance on *ACF* might "seem bizarre." (App. 11a). Nevertheless, the court below applied *ACF*, and in doing so, it erroneously extended this Court's construction of 49 U.S.C. § 11503 (b)(4) to determine the nature or extent of discrimination in fact which gives rise to scrutiny under the entirely separate and distinct Intergovernmental Tax Immunity Doctrine and 4 U.S.C. § 111. Rather, the nature and extent of discrimination in fact, which gives rise to scrutiny under the doctrine and 4 U.S.C. § 111, should be determined by the plain language of 4 U.S.C. § 111 and by the ample case law expressly applying the doctrine and the statute.

II. THE FACT THAT A LIMITED GROUP OF STATE RETIREES IS FAVORED DOES NOT REMOVE THE PRESENT CASE FROM SCRUTINY UNDER THE INTERGOVERNMENTAL TAX IMMUNITY DOCTRINE AND 4 U.S.C. § 111.

Once discrimination in fact is shown to exist by one sovereign against another, or those with whom the latter deals, such discrimination is permissible only if the disparate tax treatment is justified by, and directly related to, significant differences between the favored and disfavored governments, other than their separate identities

as such. *Davis*, 489 U.S. at 813; *Barker*, 503 U.S. at ——, 118 L.Ed.2d at 249. Discrimination in fact, to any extent, must be scrutinized under 4 U.S.C. § 111 and the doctrine. No minimum extent or scope of discrimination in fact must be shown to exist before the significant differences test is applied.[5] This is so because application of the doctrine of intergovernmental tax immunity "does not depend upon the amount of the exaction, the weight of the burden or the extent of the resulting interference with sovereign independence." *Trinityfarm Constr. Co. v. Grosjean*, 291 U.S. 466, 471 (1934). Where the doctrine applies, "the principle is an absolute one unaffected by matters or distinctions of degree." *Id.* (citing *Indian Motorcycle Co. v. United States*, 283 U.S. 570, 575 (1931)).[6]

The Petitioners "doubt the proposition that tax discrimination against the United States [or those with whom it deals] may be permissible depending on the quantum of the discrimination." *City of Manassas*, 830 F.2d at 534 n.4. In *City of Manassas*, "all users of property [including users of the property of the Commonwealth were] taxed alike, with the exception of those who use the property of the Virginia Port Authority and local transportation districts, both of which are subdivisions of the government of the Commonwealth." *Id.* at 533. "As in *Phillips*, then, the discrimination against the federal government in favor of subdivisions of the state government is obvious, even though it may not extend to all state owned lands . . . ." *Id.* The Court of Appeals struck down the tax scheme as in violation of intergovernmental

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[5] *See, Davis*, 489 U.S. at 814 ("The scope of the immunity granted or retained by the nondiscrimination clause [of 4 U.S.C. § 111] is to be determined by reference to the [Intergovernmental Tax Immunity] doctrine.").

[6] *See also, Johnson v. Maryland*, 254 U.S. 51, 55-56 (1920) ("[t]he decision in [*M'Culloch v. Maryland*, 4 Wheat. 316 (1819)] was not put upon any consideration of degree but upon the entire absence of power on the part of the state to touch in that way at least, the instrumentalities of the United States . . .").

tax immunity, placing no importance on the extent or degree of the discrimination in fact.

The fact that a small group is favored "reduce[s] the extent of discrimination . . . [but does] not eliminate it." *Phillips*, 361 U.S. at 381 n.6. In *Phillips*, this Court applied the significant differences test and invalidated the challenged tax scheme, thus finding that intergovernmental tax immunity does not permit discrimination even to a limited extent. *Id.* at 387. Accordingly, whether the favored group is relatively small and the disfavored group is relatively large, or vice versa, is of no moment in determining whether the disparate treatment must be scrutinized under the principles of intergovernmental tax immunity as applied in *Davis* and *Barker*. The extent of the discrimination in the present case is somewhat less than it would be if the retirement pay of all state and local retirees was exempted, yet, the discrimination in fact still exists. Excluding from income taxation the retirement pay of approximately four percent of all state and local government retirees (App. 2a), constitutes discrimination in fact which requires scrutiny under intergovernmental immunity principles when no federal retiree is allowed to so exclude retirement pay.[7] The holding of the court below to the contrary not only conflicts with this Court's holding in *Phillips*, and its analysis in *Grosjean* and *Indian Motorcycle Co.*, it also conflicts with the holding in *City of Manassas*.

By the clear language of 4 U.S.C. § 111, Congress has expressly made unlawful any disparate tax treatment between any federal and state employees (including retirees) based on the source of their pay. There is noth-

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[7] Moreover, "[this Court] cannot regard the impact of the discrimination as de minimus." *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 398 n.8 (1983). If all fifty states were to enact discriminatory taxation schemes similar to the challenged West Virginia statute, the resulting discriminaiton would likely be of a greater magnitude, and would certainly be more widespread.

ing in 4 U.S.C. § 111 to indicate that any extent or scope of discrimination in fact, based on source of pay, is permissible. Having consented to the taxation of the pay of federal employees, Congress certainly had the power to expressly permit some limited extent of discrimination. *Graves v. New York ex rel. O'Keefe,* 306 U.S. 466, 478 (1939); *Helvering v. Gerhardt*, 304 U.S. 405, 411 n.1 (1938). However, Congress chose to forbid any and all discrimination based on source of pay without quantitation. When Congress has so clearly prohibited any discrimination in fact based on source of pay, it is not appropriate to consider the extent or the scope of the burden or benefit resulting from such discrimination. *Graves*, 306 U.S. at 479-80.

Selecting a group of state or local retirees for more favorable tax treatment merely because of the source of pay is one type of discrimination that 4 U.S.C. § 111 is designed to prohibit. *Davis*, 489 U.S. at 815 n.4 (quoting *Phillips*, 361 U.S. at 385). Selecting a group of federal retirees for more burdensome tax treatment because of the source of pay is also prohibited. *Barker*, 503 U.S. at ——, 118 L.Ed.2d at 243. 4 U.S.C. § 111 mandates equal treatment to the extent other significant differences do not exist which justify and directly relate to the disparate tax treatment. *Davis*, 489 U.S. at 817. Disparate tax treatment based on source of pay is absolutely prohibited.

The Petitioners do not contend that 4 U.S.C. § 111, in the absence of other significant differences, necessarily requires that all federal retirees be afforded the same favorable tax treatment that is allowed to any state or local government retiree. This is because the State may comply with the mandate of equal treatment by discontinuing the favorable tax treatment of the state and local government retirees. The mandate may also be satisfied by amending the statute in a manner such that state income taxation of all public sector retirement pay is determined

by reference to a significant difference, other than source of pay, which meets the direct relationship and justification tests. However, as is the case here, it is the same nature of discrimination to afford a select group of state government retirees more favorable tax treatment as it is to place upon all federal retirees a greater tax burden, only the extent of the discrimination is less in the first instance.

An insubstantiality exception to the nondiscrimination rule of the Intergovernmental Tax Immunity Doctrine and 4 U.S.C. § 111, and thus, to the application of the significant differences analysis, would effectively permit discrimination because of source of pay as long as it was to some undefined lesser extent. Not only would such an exception clearly contravene the nondiscrimination rule of 4 U.S.C. § 111, it would also be unworkable and inherently vague and ambiguous. If an insubstantiality exception is allowed to stand, is the extent present here the upper limit of permissible discrimination based on source of pay? Is some higher percentage permissible? If so, what is it? It must be realistically anticipated that the states, in this era of increasing demands on the public fisc, will persistently test the upper limit of an insubstantiality exception. This inevitably would result in an increasing extent of discrimination against federal retirees, and an unnecessary burden on the courts, whose role it would be to repeatedly determine the permissible extent or degree of discrimination based on source of pay.

Moreover, due to the inherent fact that the number of retirees within the particular groups continuously fluctuates, the relative proportion of persons in each group continuously changes. Thus, under a insubstantiality exception, it is possible that a discriminatory tax scheme could lawfully discriminate one year and unlawfully discriminate the next year, merely because of changes in the numbers of public sector retirees in the relevant groups. The constitutionality and lawfulness of a statute

under 4 U.S.C. § 111 and the Intergovernmental Tax Immunity Doctrine must be determined by the nature of the discrimination in fact, and not by the extent of that discrimination.

Therefore, the only judicially workable and unequivocal rule must be, in accordance with the clear language of 4 U.S.C. § 111 and settled principles of the doctrine, that no extent of discrimination because of source of pay is permissible. Neither the affirmation of this rule, nor the reversal of the judgment below, would require an expansion or modification of the Intergovernmental Tax Immunity Doctrine or of the judicial precedent applying 4 U.S.C. § 111. Simple application of the significant differences analysis in all instances in which discrimination in fact is shown to exist, as this Court has invariably done, will implement that rule.

III. NO ANTI-FEDERAL INTENT NEED BE SHOWN IN ORDER TO INVALIDATE A TAX SCHEME, OR TO SUBJECT A TAX SCHEME TO SCRUTINY, UNDER THE INTERGOVERNMENTAL TAX IMMUNITY DOCTRINE OR 4 U.S.C. § 111.

The court below held as follows:

> Challenges to a state scheme under 4 U.S.C. § 111 can succeed only when one purpose of the challenged scheme is shown to discriminate against the officer or employee because of the *source* of pay or compensation. In determining whether such discrimination exists, a court will look to the totality of the circumstances to ascertain whether the intent of the scheme is to discriminate against employees or former employees of the federal government. (App. 2a) (emphasis in original).

This holding directly contravenes the mandatory precedent established by this Court and the holding of the Court of Appeals in *City of Manassas*. Once discrimination in fact is shown to exist, 4 U.S.C. § 111 and the

Intergovernmental Tax Immunity Doctrine are implicated, and the only inquiry is "whether the inconsistent tax treatment is directly related to, and justified by, 'significant differences between the two classes.'" *Davis*, 489 U.S. at 816 (quoting *Phillips*, 361 U.S. at 383-85). An anti-federal intent is not a legitimate prerequisite to application of the significant differences analysis.[8] In the context of intergovernmental tax immunity, this Court has not held that invalidation of a tax scheme depends on a showing that the state purposefully intends, or had a calculated scheme or plan, to discriminate against federal retirees. However, this was required by the court below. (App. 8a-9a).

The court below concluded, with no evidence or supporting citation, that the discriminatory tax schemes struck down in *Davis* and *Barker* were "consciously designed" to burden a less well-represented constituency. (App. 9a) Then, based on this self-serving and baseless assumption, the court below purported to engraft upon this Court's intergovernmental tax immunity analysis, the requirement that the tax statute be "consciously designed" to discriminate against federal retirees. *Id.* The court below then upheld the discrimintory tax scheme by finding that no such *mens rea* exists.

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[8] In *City of Manassas* the Court of Appeals recognized the insignificance of the State's intent:

> . . . regarding the significance of a finding that the state legislature's purpose was not to discriminate against the United States and its lessees, rather only to benefit the exempt [state] instrumentalities. First, we must question whether a State with such a taxing scheme can truly be said not to intend any discrimination against the United States, in light of the maxim that every man is considered to intend the natural and probable consequence of his acts. . . . Furthermore, even if such a lack of discriminatory intent be found, we doubt its relevance, since the United States [or those with whom it deals] would still receive the unfavorable tax treatment. . . . *City of Manassas*, 830 F.2d at 534 n.5.

The court below found that the discrimintory tax scheme reflects West Virginia's intent to benefit a limited group of state and local retirees, and not an intent to discriminate against federal retirees. (App. 9a). As a general proposition, the State may adopt measures or methods designed to benefit those in privity with it. "But if the [benefit] which it provides is in the form of a reduction in tax which discriminates against [those in privity with the Federal Government], the question remains, is it permissible?" *Phillips,* 361 U.S. at 384.[9] Whether the tax discrimination is permissible is determined by application of the significant differences analysis, and within such analysis, the intent or interest of the taxing authority is irrelevant.

This Court in *Davis* stated that "[t]he State's interest in adopting the discriminatory tax, no matter how substantial, is simply irrelevant to an inquiry into the nature of the two classes receiving inconsistent treatment." *Davis,* 489 U.S. at 816. The State's interest was deemed irrelevant by this Court because "it does nothing to demonstrate that there are 'significant differences between the two classes' themselves; rather, it merely demonstrates that the State has a rational reason for discriminating between two similar groups of retirees.' " *Id.* Consequently, West Virginia's intent to benefit certain state retirees, or its supposed lack of intent to burden federal retirees, is irrelevant because it does nothing to demonstrate whether there are significant differences between the two groups. Moreover, if it is relevant, West Virginia's intent, being to benefit a group of state and local retirees, emphasizes that the disparate tax treatment is because of the source of the pay.

The court below also found that "specialized circumstances" are present here which reflect that no anti-federal

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[9] *See, South Carolina v. Baker,* 485 U.S. 505, 516 (1988) ("[A state] cannot employ unconstitutional means to reach a constitutional end.").

intent exists, thus, removing the present case from the purview of *Davis* and *Barker*. (App. 7a). Specifically, the court below found as follows:

> In the case before us, three facts conclusively demonstrate that no calculated scheme or plan exists to discriminate against retired military personnel based on the source of their income: (1) retired military personnel are treated *more* favorably than West Virginians who have retired from civilian occupations; (2) retired military personnel are treated equally with all persons retired from the West Virginia Public Employees Retirement System and the West Virginia Teachers Retirement System; and (3) along with state public employees and teachers, military retirees are treated *substantially more favorably* than persons retired from the West Virginia Judicial Retirement System. (App. 9a-10a) (emphasis in original).

The court below erred in relying on the fact that the retirement pay of a large portion of state retirees is taxed in the same manner as the retirement pay of federal retirees. In *Barker*, the retirement pay of federal civilian retirees and state and local retirees was equally exempt from taxation while the retirement pay of military retirees was not. *Barker*, 503 U.S. at ——, 118 L.Ed.2d at 248 n.1. However, the fact that federal civilian retirees were exempt from taxation in the same manner as state and local government retirees, made the taxation of military retirees no less discriminatory, and no less unlawful.[10]

The tax treatment of private sector retirees is also irrelevant in determining whether there exists discrimination in fact requiring scrutiny under 4 U.S.C. § 111 and the Intergovernmental Tax Immunity Doctrine. This is because the doctrine has its roots in the concept of fed-

[10] *See also, Kuhn*, 817 P.2d at 101 (holding that a tax scheme that placed a heavier burden on military retirees than all other public sector retirees, including federal civilian retirees, was unlawful).

eralism and the Supremacy Clause. 4 U.S.C. § 111 has been held to grant immunity from discriminatory state taxation "coextensive with the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity." *Davis*, 489 U.S. at 813. This doctrine was first recognized in *M'Culloch v. Maryland*, 4 Wheat. 316 (1819). Nevertheless, the court below, in essence, follows the lone dissent in *Davis*, which would hold that a state tax burden, shared equally by federal retirees and a vast majority of the state's citizens, does not discriminate against those federal retirees. *Davis*, 489 U.S. at 822-23 (Stevens, J., dissenting). This Court squarely addressed and rejected this reasoning, in spite of the vigorous dissent, on the basis of prior precedent.[11] The majority of this Court stated:

> In *Phillips Chemical Co.*, however, we faced that precise situation: an equal tax burden was imposed on lessees of private, tax-exempt property and lessees of federal property, while lessees of state property paid a lesser tax, or in some circumstances, none at all. Although we concluded that "[u]nder these circumstances, there appears to be no discrimination between the Government's lessees and lessees of private property," we nonetheless invalidated the State's tax. *Davis*, 489 U.S. at 815 n.4 (internal citations omitted) (quoting *Phillips*, 361 U.S. at 381).

Moreover, contrary to the implication of the court below, in *Davis*, private sector retirees received tax treatment equal to that applied to federal civilian retirees. *Davis*, 489 U.S. at 805. Thus, the fact that private sector retirees are taxed more heavily than federal retirees in the present case, does not constitute a "specialized

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[11] Moreover, Justice Stevens, unlike the court below, later recognized the precedential value of *Davis* and concurred in the application of its majority opinion. *Barker*, 503 U.S. at ——, 118 L.Ed.2d at 254 (Stevens, J., concurring).

circumstance" which removes the present case from review under *Davis* because a similar circumstance was present in *Davis*. In *Davis*, the fact that federal civilian retirees were taxed in the same manner as private sector retirees, while state government retirees were exempt, made the taxation of the federal civilian retirees no less discriminatory.[12]

An anti-federal intent must not be a prerequisite to scrutiny under 4 U.S.C. § 111 and the Intergovernmental Tax Immunity Doctrine. The rule must be that discrimination, based on source of pay, is unlawful regardless of the State's intent. Otherwise, the subjective analysis required by an anti-federal intent exception would permit a state to discriminate because of the source of pay, and excuse such discrimination by asserting that it had no affirmative or conscious plan or design to disproportionately burden federal retirees. As recognized by the Fourth Circuit "[t]o [permit an anti-federal intent prerequisite] would allow the States to exempt [those in privity with them] on the ground that they merely sought to further their own laudable public purposes, not to burden the federal government [or those with whom it deals]." *City of Manassas*, 830 F.2d at 534 n.5.

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[12] *See also, Pledger*, 811 S.W.2d at 286 (wherein Arkansas' highest court held unconstitutional a state income tax scheme which exempted state retirees while allowing only a partial exemption for all other retirees, including private sector and federal retirees).

IV. THE DISCRIMINATION IN FACT IS UNLAWFUL BECAUSE NO SIGNIFICANT DIFFERENCE BETWEEN MILITARY RETIREES AND RETIRED POLICEMEN AND FIREFIGHTERS, OTHER THAN SOURCE OF PAY, HAS BEEN ESTABLISHED THAT JUSTIFIES AND IS DIRECTLY RELATED TO THE DISCRIMINATORY TAX SCHEME.

A. The Court Below Erred In Placing The Burden Upon The Petitioners To Establish That No Other Significant Differences Exist.

It is the burden of the State, once discrimination in fact is shown to exist, to establish that another significant difference exists which justifies and reasonably relates to the disparate tax treatment. *Davis*, 489 U.S. at 816; *Barker*, 503 U.S. at ——, 118 L.Ed.2d at 250.[13] Although the court below did not apply the significant differences analysis, it stated, "the [Petitioners] have failed to demonstrate that their job descriptions during any substantial part of their active service corresponded to the job descriptions of municipal firefighters, municipal police officers or state police officers . . . ." (App. 7a). The court below erred in placing this burden on the Petitioners and compounded that error by apparently concluding that a difference in job descriptions constitutes another significant difference *per se*.

A difference in job descriptions can serve as another significant difference only to the extent that the difference directly relates to and justifies the disparate treatment. In the present case, the respective job descriptions of the groups are irrelevant as the West Virginia income taxation scheme is source-dependent, and is not based on the profession or job description of the retiree during active service. West Virginia Code §§ 11-21-12(c)(5) and (6) re-

[13] The highest court of two other states have also placed the burden on the taxing authority. *Kuhn*, 817 P.2d at 109; *Sheehy v. Public Employees Retirement Division*, 864 P.2d 762, 769 (Mont. 1993).

peatedly use the words "retirement system" to group public retirees. These statutes do not use terms describing the retirees' professions to group public retirees. Thus, job descriptions do not directly relate to the disparate tax treatment.

B. The Plain Language And Effect Of The Relevant Provisions Of The West Virginia Code Demonstrate Clearly That The Discriminatory Tax Treatment Is Based Solely On The Source Of Pay.

West Virginia Code § 11-21-12(c)(6) provides a decreasing modification from federal adjusted gross income for purposes of imposing the West Virginia income tax, and states in relevant part, "[r]etirement income received . . . under any *West Virginia* police, *West Virginia* firemen's retirement system or the *West Virginia* department of public safety death, disability and retirement fund . . ." (emphasis added). West Virginia Code § 11-21-12(c)(5) likewise provides a decreasing modification. (App. 27a). By referring only to "retirement system[s]" in differentiating between groups of retirees for the purpose of imposing income tax thereon, West Virginia's income taxation of public retiree pay is source-dependent. Moreover, by further limiting favorable tax treatment to West Virginia retirement systems, the State further evidences its effort to discriminate based on the source of pay.

If disparate tax treatment is based on a difference other than source of pay, the direct relationship component of the significant differences test dictates that the difference invariably result in the disparate tax treatment. A state tax scheme which erects source-based classifications cannot be found lawful unless application of a proffered significant difference, other than source of pay, uniformly results in unfavorable tax treatment of all members of the disfavored group, and favorable tax treatment of all members of the favored group. *Davis*, 489 U.S. at 817. "A tax exemption truly intended to account for differences in retirement benefits [other than their source] would not dis-

criminate on the basis of the source of those benefits . . . ." *Id.*[14] This Court stated that if Michigan truly wished to tax larger pensions and exempt smaller pensions "it would discriminate on the basis of the amount of benefits received by individual retirees." *Id.* Similarly, if the State of West Virginia truly intended to impose its income tax on retirement pay of retired public employees, based on a factor other than the source of the pay, it would statutorily discriminate on the basis of that other factor.

C. The Respondent Failed To Satisfy His Burden To Demonstrate That The Discrimination In Fact Is Directly Related To And Justified By Other Significant Differences.

The Respondent proffered in the court below that the other significant difference is that "[Petitioners] are eligible to receive Social Security benefits based on their military service, while police and firefighter retirees are not eligible to receive Social Security benefits based on their service as police or firefighters." Brief for Appellant at 10, *Brown v. Mierke*, 443 S.E.2d 462 (W.Va. 1994) (No. 21923). However, Respondent's attempt to use eligibility for Social Security benefits as the other significant difference is unavailing. Eligibility for receipt of Social Security benefits does not satisfy the direct relationship test because the favored group contains members who receive Social Security benefits by reason of their service as police officers and firefighters, while the disfavored group contains

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[14] In *Davis*, the State of Michigan argued that state retirees' pay was exempt because it was generally less munificent than federal retirees' pay. This Court stated:

> Even assuming the state's estimate of the relative value of state and federal retirement benefits is generally correct, we do not believe this difference suffices to justify the type of blanket exemption at issue in this case. While the average retired federal civil servant receives a larger pension than his state counterpart, there are undoubtedly many individual instances in which the opposite holds true. *Davis*, 489 U.S. at 817.

members who do not receive Social Security benefits by reason of their military service." [15] (App. 20a-22a).

The Respondent admitted before the court below, that, other than its proffered other significant difference regarding entitlement to Social Security benefits, "no other explanation for the classifications exists." Brief for Appellant at 10, *Brown v. Mierke*, 443 S.E.2d 462 (W.Va. 1994) (No. 21923). The court below did not hold that entitlement to or receipt of Social Security benefits is another significant difference However, the court below seemed to raise the issue of similarity of job descriptions as a possible other significant difference *sua sponte*. (App. 7a). The Respondent has not previously argued that any difference, other than entitlement to and receipt of Social Security benefits, constitutes another significant difference, and he may not now proffer another factor for the first time before this Court. The only difference between the groups in the present case that meets the direct relationship requirement is source of pay, and any other proffered difference is merely "a cloak for discrimination." *Barker*, 503 U.S. at ——, 118 L.Ed.2d at 254.

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[15] Respondent sought to excuse the failure of its proffered other significant difference to meet the direct relationship test, by arguing in the court below that "rough equality in tax treatment of similarly situated [taxpayers]" is all that is required. Brief for Appellant at 11, *Brown v. Mierke*, 443 S.E.2d 462 (W.Va. 1994) (No. 21923) (citing *Allegheny Pittsburgh v. Webster County*, 488 U.S. 336, 344 (1989)). However, *Allegheny Pittsburgh* is concerned with permissible classification under the Equal Protection Clause and this Court has "made it clear . . . that [this Court's] decisions in that field are not necessarily controlling where problems of intergovernmental tax immunity are involved." *Phillips*, 361 U.S. at 385.

CONCLUSION

Grant of certiorari and reversal of the judgment below is necessary in order to enforce and affirm the unequivocal mandate of 4 U.S.C. § 111 and the Intergovernmental Tax Immunity Doctrine of nondiscrimination because of source of pay to any extent. The mode of analysis advanced by the court below must be repudiated immediately or it will hasten an open season not only on federal retirees but on others with whom the federal government deals. The fifty states, hungry for revenue, will repeatedly and persistently search for the upper limit of the acceptable extent of discrimination, and attempt to excuse the discrimination as insubstantial and lacking anti-federal intent. Discrimination based on source of pay to any extent must be absolutely prohibited by this Court if this otherwise inevitable effect of the judgment of the court below is to be avoided.

Respectfully submitted,

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August 3, 1994

APPENDICES

APPENDIX A

IN THE SUPREME COURT OF APPEALS
OF WEST VIRGINIA

JANUARY 1994 TERM

No. 21923

DALLAS C. BROWN, JR., *et al.*,
Appellees,

v.

ALAN L. MIERKE, ACTING STATE TAX COMMISSIONER
OF THE STATE OF WEST VIRGINIA,
Appellant.

Appeal from the Circuit Court of Kanawha County
Honorable Andrew A. MacQueen, Judge
Civil Action No. 90-C-3341

REVERSED

Submitted: 25 January 1994

Filed: 24 March 1994

JUSTICE NEELY delivered the Opinion of the Court.

SYLLABUS BY THE COURT

1. In allowing exemptions for pensions of municipal firemen, municipal policemen and for payments from the Department of Public Safety Death, Disability and Retire-

ment Fund, the total structure of West Virginia's system for taxing personal income does not discriminate against retired members of the armed forces of the United States in violation of 4 U.S.C. § 111.

2. Challenges to a state tax scheme under 4 U.S.C. § 111 can succeed only when one purpose of the challenged scheme is shown to discriminate against the officer or employee because of the *source* of pay or compensation. In determining whether such discrimination exists, a court will look to the totality of the circumstances to ascertain whether the intent of the scheme is to discriminate against employees or former employees of the federal government.

Neely, J.:

Subsection (c)(6) of *West Virginia Code* 11-21-12 [1993] provides for a modification reducing federal adjusted gross income for state income tax purposes in the entire amount a taxpayer receives from, "pensions and annuities . . . under any West Virginia police, West Virginia firemen's retirement system or the West Virginia Department of Public Safety Death, Disability and Retirement Fund." As of 1991, the 1,624 retired police and firefighters exempted from taxation by *Code* 11-21-12(c)(6) [1993] constitute about four percent of all state and local retirees in West Virginia.

The appellees before us, former officers and enlisted personnel of the armed forces of the United States, are retired and receive military pensions. Federal tax law includes military pensions in federal adjusted gross income. Under *West Virginia Code* 11-21-12(a) [1993], federal adjusted gross income constitutes a person's adjusted gross income for purposes of the West Virginia personal income tax, subject to exemptions set forth in *West Virginia Code* 11-21-12(b) and (c) [1993]. *West Virginia Code* 11-21-12(c)(5) [1993] allows a modification decreasing federal adjusted gross income by the

amount of all forms of military retirement in a maximum amount of $2,000. A military retiree (or any other taxpayer) who has reached age 65 is entitled to reduce his or her adjusted gross income in a maximum amount of $8,000. *West Virginia Code* 11-21-12(c)(7) [1993].

Because military pensions are included in West Virginia adjusted gross income, the West Virginia personal income tax is imposed on military retirement pay. *Code* 11-21-3 [1993]. Subject to the $2,000 exclusion of *Code* 11-21-12(c)(5) [1993] or the $8,000 exclusion of *West Virginia Code* 11-21-12(c)(7) [1993], military retirees are required to report their military retirement benefits as income on their tax returns. *West Virginia Code* 11-21-51 [1987].

In the circuit court, the appellees sought a declaratory judgment to establish whether the West Virginia tax scheme in question—a scheme that taxes the lion's share of federal military pensions while exempting retirement benefits received from any West Virginia municipal police retirement system, West Virginia municipal firemen's retirement system, and the West Virginia Department of Public Safety Death, Disability and Retirement Fund—discriminates against military retirees in violation of 4 U.S.C. § 111, the Public Salary Act of 1939. The circuit court determined that West Virginia's scheme *does* discriminate against military retirees. Upon petition of the State Tax Commissioner, we granted this appeal. We reverse.

I.

A concise history of the doctrine of intergovernmental tax immunity as well as the role of Section 111 of the Public Salary Act of 1939, 4 U.S.C. § 111, is provided by Justice Kennedy in *Davis v. Michigan Department of Treasury*, 489 U.S. 803, 810-813 (1989):

> Section 111 was enacted as part of the Public Salary Tax Act of 1939, the primary purpose of which was to impose federal income tax on the salaries of

all state and local government employees. Prior to adoption of the Act, salaries of most government employees, both state and federal, generally were thought to be exempt from taxation by another sovereign under the doctrine of intergovernmental tax immunity. This doctrine had its genesis in *McCulloch v. Maryland*, 4 Wheat 316, 4 L.Ed. 579 (1919), which held that the State of Maryland could not impose a discriminatory tax on the Bank of the United States. Chief Justice Marshall's opinion for the Court reasoned that the Bank was an instrumentality of the Federal Government used to carry into effect the Government's delegated powers, and taxation by the State would unconstitutionally interfere with the exercise of those powers. *Id.* at 425-437.

For a time, *McCulloch* was read broadly to bar most taxation by one sovereign of the employees of another. *See Collector v. Day*, 11 Wall. 113, 124-128, 20 L.Ed. 122 (1871) (invalidating federal income tax on salary of state judge); *Dobbins v. Commissioners of Erie County*, 16 Pet 435, 10 L.Ed. 1022 (1842) (invalidating state tax on federal officer). This rule "was based on the rationale that any tax on income a party received under a contract with the government was a tax on the contract and thus a tax 'on' the government because it burdened the government's power to enter into the contract." *South Carolina v. Baker*, 485 U.S. 505, 518, 108 S.Ct. 1355, 1364, 99 L.Ed.2d 592 (1988).

In subsequent cases, however, the Court began to turn away from its more expansive applications of the immunity doctrine. Thus, in *Helvering v. Gerhardt*, 304 U.S. 405, 58 S.Ct. 969, 82 L.Ed. 1427 (1938), the Court held that the Federal Government could levy nondiscriminatory taxes on the incomes of most state employees. The following year, *Graves v. New York ex rel. O'Keefe*, 306 U.S. 4676, 486-

487, 59 S.Ct. 595, 601-602, 83 L.Ed. 927 (1939), overruled the *Day-Dobbins* line of cases that had exempted government employees from nondiscriminatory taxation. After *Graves,* therefore, intergovernmental tax immunity barred only those taxes that were imposed directly on one sovereign by the other or that discriminated against a sovereign or those with whom it dealt.

It was in the midst of this judicial revision of the immunity doctrine that Congress decided to extend the federal income tax to state and local government employees. The Public Salary Tax Act was enacted after *Helvering v. Gerhardt, supra,* had upheld the imposition of federal income taxes on state civil servants, and Congress relied on that decision as support for its broad assertion of federal taxing authority. S.Rep. No. 112, 76th Cong., 1st Sess., 5-9 (1939) H.R.Rep. No. 26, 76th Cong., 1st Sess., 2-3 (1939). However, the Act was drafted, considered in Committee, and passed by the House of Representatives before the announcement of the decision in *Graves v. New York ex rel. O'Keefe, supra,* which for the first time permitted state taxation of federal employees. As a result, during most of the legislative process leading to adoption of the Act it was unclear whether state taxation of federal employees was still barred by intergovernmental tax immunity despite the abrogation of state employees' immunity from federal taxation. See H.R.Rep. No. 26, *supra,* at 2 ("There are certain indications in the case of *McCulloch v. Maryland,* 4 Wheat. 316 [4 L.Ed. 579] (1819), . . . that . . . Federal officers and employees may not, without the consent of the United States, be subjected to income taxation under the authority of the various States").

Dissatisfied with this uncertain state of affairs, and concerned that considerations of fairness demanded equal tax treatment for state and federal employees,

Congress decided to ensure that federal employees would not remain immune from state taxation at the same time that state government employees were being required to pay federal income taxes. See S.Rep. No. 112, *supra*, at 4; H.R.Rep. No. 26, *supra*, at 2. Accordingly, § 4 of the proposed Act (now § 111) expressly waived whatever immunity would have otherwise shielded federal employees from nondiscriminatory state taxes.

By the time the statute was enacted, of course, the decision in *Graves* had been announced, so the constitutional immunity doctrine no longer proscribed nondiscriminatory state taxation of federal employees. In effect, § 111 simply codified the result in *Graves* and foreclosed the possibility that subsequent judicial reconsideration of that case might reestablish the broader interpretation of the immunity doctrine.

Section 111 did not waive all aspects of intergovernmental tax immunity, however. The final clause of the section contains an exception for state taxes that discriminate against federal employees on the basis of the source of their compensation. This nondiscrimination clause closely parallels the nondiscrimination component of the constitutional immunity doctrine which has, from the time of *McCulloch v. Maryland*, barred taxes that "operat[e] so as to discriminate against the Government or those with whom it deals." *United States v. City of Detroit*, 355 U.S. 466, 473, 78 S.Ct. 474, 478, 2 L.Ed.2d 424 (1958). *See also McCulloch v. Maryland, supra*, 4 Wheat at 436-437; *Miller v. Milwaukee*, 272 U.S. 713, 714-715, 47 S.Ct. 280, 280-281, 71 L.Ed. 487 (1927); *Helvering v. Gerhardt, supra*, 304 U.S., at 413, 58 S.Ct., at 972; *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 385, 80 S.Ct. 474, 480, 4 L.Ed.2d 384 (1960); *Memphis Bank & Trust Co. v. Garner*, 459 U.S.

392, 397, and n.7, 103 S.Ct. 692, 696, and n.7, 74 L.Ed.2d 562 (1983).

II.

Under the appellees' theory of the case, the Supreme Court's holdings in *Davis v. Michigan, supra* and *Barker v. Kansas*, 503 U.S. ——, 112 S.Ct. 1619 (1992) establish that West Virginia's exemption of certain firefighters' and police officers' retirement benefits renders the tax of military pensions prohibited and discriminatory. We disagree. The situation this case comprehends is surpassingly narrow: the number of retirees exempted under the allegedly discriminatory statute constitutes less than four percent of all *State* government retirees in West Virginia and a far lower percentage of all tax-filing retirees; the appellees have failed to demonstrate that their job descriptions during any substantial part of their active service corresponded to the job descriptions of municipal firefighters, municipal police officers or state police officers; all tax filers retired from the West Virginia Public Employees Retirement System and the West Virginia Teachers Retirement System are taxed identically with retired federal military personnel; and, persons retired from the Armed Forces of the United States, the West Virginia Public Employees Retirement System, and the West Virginia Teachers Retirement System receive *more* favorable tax treatment than persons retired from either the West Virginia Judicial Retirement System or private industry.

In such specialized circumstances, the controlling case is neither *Davis, supra* or *Barker, supra.* In *Davis, supra,* the Supreme Court held that Michigan's income tax scheme violated 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity because Michigan fully taxed all federal pensions while exempting *all* state pensions. The Court held that any difference in tax treatment between federal and state employees must be justified by significant differences between the two groups. According to the Court, Michigan's justification for its

statutory exemption—its interest in hiring and retaining qualified civil servants—was irrelevant to any inquiry into the difference between the two classes, no matter how substantial such an interest might be.

In response to Michigan's argument that the exemption was designed to compensate for compartively lesser returns afforded by state retirement benefits as compared to federal benefits, the Supreme Court stated that although this was probably true when comparing the average state employee to the average federal employee, it was certainly not true in a number of instances. Furthermore, the court concluded, if the difference in pay were truly the state's motivation, it would have adopted a statutory scheme based upon the amount of retirement benefits received, not upon *the source of the benefits.*

After *Davis*, the Supreme Court held in *Barker v. Kansas, supra*, that 4 U.S.C. § 111 also applies to military retirement. In *Barker*, Kansas taxed military retirement while exempting all state and local retirement benefits and most federal pensions.[1] The Supreme Court found the tax on military pensions discriminatory under 4 U.S.C. § 111 because it failed to pass the test of "whether the inconsistent tax treatment is directly related to, and justified by significant differences between the two classes."

The appellees in the case before us maintain that, pursuant to the holding in *Davis* and *Barker*, the test of whether a state tax scheme violates 4 U.S.C. § 111 is whether there exists substantial differences between the two classes that justify the discrimination. We agree that the holdings in *Davis* and *Barker* would appear to call into question West Virginia's scheme that exempts a narrow class of state employees from state taxation while taxing federal employees. However, West Virginia's scheme dif-

[1] Military retirement, the retirement benefits received by certain officials of the Central Intelligence Agency, National Oceanic and Atmospheric Association, the Public Health Service and retired federal judges were taxable under the Kansas statute.

fers from the Michigan and Kansas schemes invalidated by the Supreme Court in that there is no intent in the West Virginia scheme to discriminate *against* federal retirees; rather, the intent is to give a benefit to a very narrow class of former state and local employees. This may at first appear to be a distinction without a difference, but political reality demonstrates that the distinction is viable, as the case of *AFC Industries,* —— U.S. —— (62 LW 4097) (1994), discussed *infra,* demonstrates. In both Michigan and Kansas, the schemes struck down by the Supreme Court were consciously designed to place lower taxes on the better organized (and therefore politically more powerful) constituencies and higher taxes on the badly organized (and therefore politically weaker) constituencies.

It hardly takes a road map for us to figure out that state employees in Michigan constitute a powerful, ongoing lobby that is well organized, well funded, and backed up by election day artillery. In contrast, federal employees in Michigan constitute a small proportion of the electorate, with lobbying efforts aimed predominantly at Washington from whence cometh both their rate of pay and conditions of employment. Thus, although postal workers may be a well-organized national lobby, they are a nugatory presence in a local state house.

In Kansas, the tax scheme accommodated both retired state employees and most retired federal civilian employees, imposing higher taxes on only retired military personnel and certain exotic federal civilian retirees like CIA agents and federal judges. In doing so, the Kansas legislature chose to exact taxes from a segment of the population unlikely to retaliate politically because their national service had kept them away from the local political clubhouse.

In the case before us, three facts conclusively demonstrate that no calculated scheme or plan exists to discriminate against retired military personnel based on the source

of their income: (1) retired military personnel are treated *more* favorably than West Virginians who have retired from civilian occupations; (2) retired military personnel are treated equally with all persons retired from the West Virginia Public Employees Retirement System and the West Virginia Teachers Retirement System; and (3) along with state public employees and teachers, military retirees are treated *substantially more favorably* than persons retired from the West Virginia Judicial Retirement System.

In *Department of Revenue v. ACF Industries, Inc., supra*, Oregon exempted from its *ad valorem* property tax various classes of business personal property, but not railroad cars owned by various carlines. The carlines filed suit in federal court alleging that the tax violated the Railroad Revitalization and Regulatory Reform Act of 1976 because it exempted certain classes of commercial property from taxation whilst taxing railroad cars in full. The Supreme Court held that the Railroad Revitalization and Regulatory Reform Act of 1976 did not limit the states' discretion to *exempt* non-railroad property (but not railroad property) from generally applicable *ad valorem* property taxes. The court held that "another tax that discriminates against a rail carrier" is a residual category designed to reach any discriminatory state tax, including property taxes, but that the whole structure of the tax protections offered by the Railroad Revitalization and Regulatory Reform Act of 1976 did not intend to *prohibit normal property tax exemptions.* In this last regard the court said:

> "We hold that a state may grant exemptions from a generally applicable ad valorem property tax without subjecting the taxation of railroad property to challenge under the relevant provision of the 4R Act, Section 306 (1)(d), 49 U.S.C. 11503 (b)(4)."

That today's decision in this military pension case is grounded on a railroad car case rather than a state em-

ployee exemption case may at first seem bizarre, but the facts of the railroad car case (*AFC Industries*) are far closer to the case before us than to either *Davis* or *Barker*. Indeed, in *AFC Industries* the Supreme Court specifically made reference to the problem of states' taxing constituencies that had little, if any, local political power. In this regard the Court stated:

> "When drafting the legislation, Congress was aware that the railroads 'are easy prey for state and local tax assessors' in that they are 'nonvoting, often nonresident, targets for local taxation' who cannot easily remove themselves from the locality." *AFC Industries, supra* at 4097 (1994).
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> * * * *
>
> ". . . this is not a case in which the railroads—either alone or as part of some isolated and targeted group —are the only commercial entities subject to an ad valorem property tax. *Id.* at 4101 (1994).

In the case before us, the state's decision to exempt fire and police pensions from taxation under the state income tax is more like the property tax exemptions in *AFC Industries* than the broad-based schemes to discriminate found in *Davis* and *Barker*.[2] Thus, the statutory language of 4 U.S.C. § 111 is relevant:

> "The United States consents to the taxation of pay or compensation for personal services as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiciton, *if the taxation does not discriminate against the officer or employee because of the source of pay or compensation.*" [Emphasis added].

That the judges of this Court, statewide elected officials with rather substantial personal political followings

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[2] If nothing else, none of the petitioners before us has asserted that his or her job description was in any way close to the job description of firemen or state and local policemen.

and not a few friends in the West Virginia Legislature, are taxed at a substantially *higher* rate than retired members of the Armed Forces of the United States, and both military retirees and the majority of retired state employees are taxed at *lower* rates than West Virginians retired from private sector occupations renders it extraordinarily difficult to infer that *any* of the pernicious dynamics that either the ancient doctrine of intergovernmental tax immunity or 4 U.S.C. § 111 are designed to remedy is implicated.[3] Accordingly, the judgment of the Circuit Court of Kanawha County is reversed.

Reversed.

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[3] As Professor Ely puts it in *Democracy and Distrust* 84-85 (1980):

> [E]ven before the enactment of the Equal Protection Clause, the Supreme Court was prepared at least under certain conditions to protect the interests of minorities that were not literally voteless by constitutionally tying their interests to those of groups that did possess political power—and, what is the same thing, by intervening to protect such interests when it appeared that such a guarantee of "virtual representation" was not being provided. In the landmark case of *McCulloch v. Maryland*, decided in 1819, the Court invalidated a state tax on the operations of all banks (preeminently including the Bank of the United States) not characterized by the state legislature. Toward the end of Chief Justice Marshall's Court opinion, there appears a potentially baffling qualification: "This opinion . . . does not extend to a tax paid by the real property of the bank, in common with the other real property within the state, nor to a tax imposed on the interest which the citizens of Maryland may hold in this institution, in comcon with other property of the same description throughout the state." [footnote omitted]. What ever did he have in mind? It can't have been that he knew the sorts of property taxes mentioned were in fact less burdensome, for nothing in his opinion had indicated that the tax the Court was invalidating was in fact disabling or even burdensome. Indeed it was at the heart of his argument that no such showing was necessary: "the power to tax involves the power to destroy" and a little tax on bank operations was declared as impermissible as a big one. A tax on the land on which the local branch of the Bank

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of the United States sits also has the potential to destroy, however. *Either* tax, if it got out of hand—and there was no indication that either had—could destroy the Bank.

By now we should be in a position to spot the trick right away: it lies in Marshall's indication that the real estate tax would have to be "in common with the other real property within the state," the tax on any interest held by citizens "in common with other property of the same description throughout the state." The unity of interest with all Maryland property owners assured by this insistence on equal treatment would protect the Bank from serious disablement by taxes of this sort. The power to tax real or personal property *is* potentially the power to destroy. But people aren't lemmings, and while they may agree to disadvantage themselves somewhat in the service of some overriding social good, they aren't in the habit of destroying themselves en masse.

APPENDIX B

IN THE CIRCUIT COURT
OF KANAWHA COUNTY, WEST VIRGINIA

Civil Action No. 90-C-3341

DALLAS C. BROWN, JR., *et al.*,
Plaintiffs,

v.

ALAN L. MIERKE, Acting State Tax Commissioner
of the State of West Virginia,
Defendant.

ORDER

This is a civil action for declaratory judgment wherein the plaintiffs seek a prospective ruling of the Court that the tax scheme set forth in W. Va. Code § 11-21-12 is unconstitutional and contrary to federal statutory law. The case is currently pending before this Court on Plaintiffs' Motion for Summary Judgment.

FINDINGS OF FACT

1. Each of the plaintiffs in this action is a former officer or enlisted person of one of the branches of the United States Armed Forces, who is retired from the branch of the armed forces in which he or she served.

2. Each of the plaintiffs currently receives monthly pension benefits as a result of his or her service in the United States Armed Forces.

3. Military retirement benefits are included in federal adjusted gross income.

4. The West Virginia Code provides that an individual's adjusted gross income for purposes of the West Virginia personal income tax shall be that individual's federal adjusted gross income, subject to certain modifications. W. Va. Code § 11-21-12(a).

5. Each of the plaintiff's military retirement benefits are subject to the West Virginia personal income tax. By reason of the provisions of W. Va. Code § 11-21-12 (c)(5), each of the plaintiffs may decrease his or her West Virginia adjusted gross income by a maximum of $2,000. (This same modification, limited to $2,000, is available to individuals who receive benefits from the teachers retirement system, the West Virginia public employees retirement system and from federal retirement systems to which 4 U.S.C. § 111 applies).

6. An individual who receives retirement benefits from more than one of the sources listed in § 11-21-12(c)(5) (e.g. public employees retirement system, state teachers retirement system, federal retirement systems to which 4 U.S.C. § 111 applies), is limited to a total modification in the amount of $2,000.

7. West Virginia Code § 11-21-12(c)(6) provides that the entire amount of retirement benefits received from any West Virginia municipal police retirement system, West Virginia municipal firemen's retirement system and the West Virginia department of public safety death, disability and retirement fund constitute a modification reducing federal adjusted gross income. The entire amount of the benefits listed in W. Va. Code § 11-21-12(c)(6) are not subject to the West Virginia personal income tax.

8. By reason of the fact that military retirement benefits are included in West Virginia gross income, the West Virginia personal income tax is imposed on those benefits. W. Va. Code § 11-21-3.

9. Military retirees are required to report those amounts as income on their tax returns, in the same man-

ner as all West Virginia residents are required to report their income. W. Va. Code § 11-21-51.

10. Military retirees are required to pay tax on their military retirement benefits. W. Va. Code § 11-21-52.

11. To the extent that state income tax is not withheld from the benefits paid to military retirees, they must make declarations of estimated tax. W. Va. Code § 11-21-55.

12. Unless state income tax is withheld, military retirees must make payments of estimated tax on their retirement benefits. W. Va. Code § 11-21-56.

13. If a military retiree does not pay the West Virginia personal income tax on military reitrement benefits, he or she is subject to the enforcement provisions of the Tax Procedures Act. W. Va. Code § 11-10-1, *et seq.*

14. A military retiree who does not pay tax on military retirement benefits is subject to assessment of the tax due. W. Va. Code § 11-10-7.

15. A lien may be placed on the property of such individual. W. Va. Code § 11-10-12.

16. Such an individual is subject to levy and distraint of that person's property. W. Va. Code § 11-10-13. Such an individual is also liable for the payment of interest, additions to tax and penalties. W. Va. Code §§ 11-10-17, 18 and 19.

CONCLUSIONS OF LAW

1. The plaintiffs clearly have standing to bring this action. Even if only one of the plaintiffs has standing to bring the suit, it may be maintained. The Affidavit of Colonel Jack M. Marden, United States Army (Ret.), In Support of Plaintiffs' Motion for Summary Judgment demonstrates that he has standing to bring this action.

2. The Court has given the defendant the opportunity to conduct an evidentiary hearing with regard to the issue of standing. The defendant has not used this opportunity to present evidence which would show that none of the defendants have standing to maintain this action.

3. The petitioners contend that the provisions of W. Va. Code § 11-21-12(c) discriminate between military retirees and police and firemen who are retired, and that this discrimination is based solely on the source of the income. They contend that this discrimination violates the constitutional doctrine of intergovernmental tax immunity and the provisions of 4 U.S.C. § 111, as interpreted by the Supreme Court in *Davis v. Michigan,* 489 U.S. 803, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989).

4. Article 4, Section 111 of the United States Code provides, in relevant part:

> The United States consents to the taxation of pay or compensation for personal services as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of pay or compensation.

5. A state may not construct its tax laws in a manner so as to discriminate against federal employees and retirees and in favor of state employees and retirees based solely on the source of income. *Davis, supra.*

6. In *Davis* the United States Supreme Court held that any difference in the tax treatment between federal and state employees or retirees "must be justified by significant differences between the two classes." Id. at 816, 109 S.Ct. at ——, 103 L.Ed.2d at 905. A state's interest in adopting a tax which discriminates in favor of state employees and against federal employees, no matter how substantial, is irrelevant to an analysis of the difference between the two classes.

7. In *Davis,* the State of Michigan argued that its tax scheme was justified by the state's interest in hiring and retaining qualified civil servants. The Supreme Court held that this demonstrated a reason for the discrimination, but not a substantial difference between the two classes which justified the discriminatory tax.

8. In *Davis,* the State of Michigan also argued that its tax scheme was justified by the fact that, in most instances, the retirement benefits paid by the state were less munificent than those paid by the federal government. The Supreme Court also held that this basis did not constitute a justification for the discriminatory tax. A tax scheme truly designed to compensate for the payment of less munificent benefits would be based upon the amount of retirement benefits received, not upon their source.

9. The tax commissioner has presented evidence to show that military retirees are not singled out for discriminatory tax treatment because, he argues, they are taxed in the same manner as are a majority of state retirees. However, the plaintiffs are subject to less favorable tax treatment than retired state and municipal policemen and municipal firemen who receive benefits from state or municipal retirement systems. The fact that they are taxed in the same manner as a majority of state retirees does not permit this Court to forego an analysis of the differences between retired military personnel and retired state policemen and municipal policemen and firemen.

10. The defendant points to a number of differences between military retirees, on the one hand, and retired state troopers, municipal policemen and municipal firemen, on the other hand. Among those differences are:

a) Military retirees remain members of the military;

b) Military retirees are subject to the Uniform Code of Military Justice;

c) Military retirees may forfeit all or part of their military retirement benefits if they participate in certain activities (e.g. taking Federal Civil Service Employment, giving up United States citizenship, accepting employment with ε foreign government or selling supplies to the Defense Department);

d) Military retirees may be recalled to active duty;

e) Members of the armed forces may retire after 20 years and there is no minimum retirement age; and

f) Military retirement is noncontributory.

11. In defending the West Virginia tax scheme, the tax commissioner must do more than merely point to differences between the federal and state employees who are subject to different tax treatment. He must demonstrate how these differences are significant and how they are directly related to and justify the discriminatory tax scheme. This is the test enunciated by the United States Supreme Court in *Davis, supra,* and it must be applied in this case. Every difference set forth by the tax commissioner to attempt to justify the West Virginia tax scheme must be analyzed under this test. If the difference is not significant or if it does not justify the discrimination in taxation, then it fails to meet the *Davis* standard.

12. In *Barker v. Kansas,* 503 U.S. ——, 112 S.Ct. 1619, 118 L.Ed.2d 243 (1992), the State of Kansas argued that the same factors which have been advanced by the defendant in the present action constituted significant differences which justified the Kansas tax scheme.

13. The United States Supreme Court rejected the arguments advanced by the State of Kansas, which requires this Court to reject the same arguments advanced by the defendant.

14. In *Davis, supra,* the United States Supreme Court held that any difference in taxation intended to compensation for differences in the amount of benefits would discriminate not on the source of the benefits, but on the amount of benefits. Michigan attempted to justify its discriminatory tax on the grounds that federal retirement benefits were more munificent than those provided by the state. The Supreme Court noted that this did not justify a blanket exemption for state employees vis-a-vis federal employees, holding:

> [W]e do not believe this difference suffices to justify the type of blanket exemption at issue in this case. A tax exemption truly intended to account for differences in retirement benefits would not discriminate on the basis of the *source* of those benefits, . . . rather, it would discriminate on the basis of the amount of benefits received by individual retirees.

Id. at 817. The West Virginia tax scheme does not discriminate on the basis of the amount of benefits, years of service or age at retirement. Instead, if discriminates against federal military retirees based solely on the source of benefits. This type of discrimination is improper under the *Davis* holding.

15. Another factor cited by the commissioner as a significant difference between military retirees and retired policemen and firemen is the fact that military retirees receive Social Security benefits, while retired policemen and firemen do not. This contention is not universally true.

16. It is significant that the tax commissioner does not contend that *all* military retirees are eligible to receive Social Security benefits. In fact, he concedes that only *most* are eligible. This fact is borne out by two publications pertaining to military retirement. *See Handbook on Retirement Services (DA PAM 600-5),* Headquarters, Department of the Army, August 1982, at

p. 8-1, which is furnished to retired army personnel, and the *Retired Military Almanac,* at p. 166. These publications succinctly summarize the status of military retirees whose service was confined to the period prior to January 1, 1957. These retirees receive military retirement benefits and they are not entitled to receive Social Security.

17. In addition to the fact that a number of military retirees do not receive Social Security benefits, several municipalities have retired policemen and firemen who receive both Social Security benefits and benefits from the municipal retirement system. Pursuant to "Modification No. 259 To West Virginia State Social Security Agreement", entered into pursuant to Act Jan. 2, 1976, P.L. 94-202, § 6, 89 Stat. 1136, retired policemen and firemen of the municipalities listed in the appendix to the modification are covered by Social Security. Those municipalities listed in the Appendix as "unimplemented" did not have municipal retirement systems. Those municipalities listed in the Appendix as having implemented retirement system, have their retired policemen and firemen covered by the named municipal retirement system and, pursuant to the agreement, by Social Security. Their retirees receive both types of benefits.

18. Several municipalities listed in the appendix (e.g. the City of Chester and the Town of Star City), which had not implemented municipal retirement systems at the time of Modification No. 259, now have municipal retirement systems. *See* Affidavit of Gail Moore. Pursuant to Modification No. 259, their retired policemen are also covered by Social Security.

19. Receipt of Social Security benefits is not the absolute difference between military retirees and retired policemen and firemen that the tax commissioner claims it to be. Certain military retirees and certain retired policemen and firemen receive Social Security benefits. Certain military retirees and certain retired policemen and firemen do

not. The line separating those who receive Social Security benefits from those who do not is not the same as that which separates military retirees from retired policemen and firemen.

20. In *Davis,* Michigan attempted to justify its discriminatory tax on the grounds that federal retirement benefits were more munificent state retirement benefits. The Court held that a tax exemption truly intended to account for differences in the amount of compensation would have differentiated on that basis, and not on the source of compensation. Similiarly, if the West Virginia Legislature had truly intended that the receipt of Social Security benefits constitutes a significant difference justifying a discriminatory tax (and there is no legislative history to demonstrate that it so intended), it would have created a statutory distinction based solely upon that factor and not upon the source of the funds. The Legislature would have extended the modification decreasing federal adjusted gross income to military retirees who do not receive Social Security benefits, and it would have withheld the modification from retired policemen and firemen who received Social Security benefits. As in *Davis,* the difference alleged by the tax commissioner does not justify a tax scheme which discriminates on the basis of the source of income.

21. The tax commissioner has shown that there are some differences between military retirement benefits and the retirement benefits of retired policemen and firemen, and that there are differences between the recipients themselves. The United States Supreme Court has rejected most of these distinctions as not being so significant as to justify discrimination in taxation. *Barker, supra.* With respect to the receipt of Social Security benefits, it is clear that this difference is not directly related to and does not justify a tax which discriminates against military retirees. The tax commissioner has not met the requirements of *Davis.*

22. There is no historical basis to show that receipt of Social Security benefits was a factor in discriminating between military and non-military retirees. For tax years immediately preceding 1987, the $2,000 per year limitation on the modification to federal adjusted gross income for military retirement did not exist. Military retirees received the same treatment as retired policemen and firemen. Their benefits were not subject to West Virginia personal income tax. The receipt of Social Security benefits was not a factor necessitating a difference in taxation prior to 1987. There is nothing in the 1987 amendment to show that it was a factor at the time the statute was amended. The commissioner is attempting to provide an after-the-fact justification for a discriminatory tax, which was passed as a revenue producing measure.

23. The tax commissioner also attempts to show that the West Virginia tax scheme does not discriminate. He first argues that military retireemnt pay is not "singled out" for "taxation" by the statute. However, 4 U.S.C. § 111 prohibits taxation which discriminates against officers or employees of the United States because of the source of their income. Discrimination against military retirees vis-a-vis retired policemen and firemen is apparent from a reading of the statute. The statute explicitly bases the difference in modifications on the source of the retirement benefits.

24. In an attempt to justify the tax, the tax commissioner admits that it discriminates. He attempts to justify this discrimination by arguing that a small, discrete group of state retirees, policemen and firemen, receive tax treatment which is more favorable than military retirees. He argues that this discrimination is based upon differences which are significant. As shown above, the differences are not significant, and they are neither directly related to nor do they justify discrimination in taxation.

25. The tax commissioner argues that the statutory discrimination is somehow permissible because the discre-

tionary feature of the tax is contained in the section permitting modifications to federal adjusted gross income, rather than in the section which levies the tax. This argument exalts form over substance. Regardless of the mechanics of the tax scheme, the result is that the benefits of retired policemen and firemen are not taxed, while military retirement benefits are.

26. The tax commissioner also argues that there is a "political check" in place in that the tax burden falls on a significant group of citizens who can be counted upon to use their votes to keep the tax from becoming excessive. In effect, the commissioner contends that a discriminatory tax is permissible so long as the majority approves it and the class discriminated against is politically unable to prevent it. This argument is contrary to the *Davis* decision and 4 U.S.C. § 111, which prohibits discrimination based solely on the source of income.

27. The tax commissioner also maintains that military retirement benefits are different from federal civil service retirement benefits. He contends that since *Davis* concerned civil service retirement benefits and the present action concerns military retirement benefits, *Davis* does not control. The subsequent decision of the United States Supreme Court in *Barker* requires the Court to rule against the defendant on this issue.

28. The Court concludes that the tax scheme embodied in W. Va. Code § 11-21-12(c)(5) and (6) improperly discriminates against the plaintiffs, in violation of the constitutional doctrine of intergovernmental tax immunity and 4 U.S.C. § 111. Therefore, the Court declares that the tax, as written and administered, is invalid.

29. In determining the proper remedy available to the taxpayer in the case of a tax which discriminates between state and federal employees, this Court must abide by the decision of the United States Supreme Court in *Davis*, wherein it stated that the appropriate remedy is a "*man-*

date of equal treatment, . . ." (Emphasis in original). It follows from this that the tax commissioner is required to administer the tax in a manner which does not discriminate between the plaintiffs and retired policemen and firemen who receive benefits described in W. Va. Code § 11-21-12(c)(6).

30. The Court will not dictate to the tax commissioner how he is to administer the tax, except to require him to administer it equally.

ORDER

Based on the foregoing, the Court does hereby DECLARE, ORDER and ADJUDGE that the tax scheme embodied in W. Va. Code § 11-21-12(c)(5) and (6) violates the constitutional doctrine of intergovernmental tax immunity and 4 U.S.C. § 111. The Court does FURTHER DECLARE, ORDER and ADJUDGE that the discriminatory affects of the tax scheme may be eliminated by mandating equal treatment between the classes, and the tax commissioner is hereby ORDERED to administer the tax so that military retirees and those receiving benefits described in W. Va. Code § 11-21-12(c)(6) are treated equally.

The objection of the defendant to all aspects of this decision deemed to be adverse are saved.

DATE: 4/13/93

ENTER:

/s/ Andrew A. MacQueen
Judge

APPENDIX C

STATE OF WEST VIRGINIA

At a Regular term of the Supreme Court of Appeals continued and held at Charleston, Kanawha County, on the 5th day of May, 1994, the following order was made and entered:

No. 21923

DALLAS C. BROWN, JR., *et al.*,
Plaintiffs Below, Appellees
vs.

ALAN L. MIERKE, Acting State Tax Commissioner
of the State of West Virginia,
Defendant Below, Appellant

The Court, having maturely considered the petition for rehearing and reargument filed in the above-captioned case, is of opinion to, and doth hereby, deny the prayer of the petitioner and doth hereby order that the final order entered herein be made absolute and certified as heretofore directed.

A True Copy

Attest: /s/ Ancil G. Ramey
Clerk
Supreme Court of Appeals

APPENDIX D

STATUTORY PROVISIONS

W.Va. Code § 11-21-12(c)(5) (1991 & Supp. 1994)

(c) *Modifications reducing federal adjusted gross income.*—There shall be subtracted from federal adjusted gross income to the extent included therein:

* * *

(5) Annuities, retirement allowances, returns of contributions and any other benefit received under the West Virginia public employees retirement system, the West Virginia state teachers retirement system and all forms of military retirement, including regular armed forces, reserves and national guard, including any survivorship annuities derived therefrom, to the extent includible in gross income for federal income tax purposes: Provided, That notwithstanding any provisions in this code to the contrary this modification shall be limited to the first two thousand dollars of benefits received under the West Virginia public employees retirement system, the West Virginia state teachers retirement system and all forms of military retirement including regular armed forces, reserves and national guard, including any survivorship annuities derived therefrom, to the extent includible in gross income for federal income tax purposes for taxable years beginning after the thirty-first day of December, one thousand nine hundred eighty-six; and the first two thousand dollars of benefits received under any federal retirement system to which Title 4 U.S.C. § 111 applies: Provided, however, That the total modification under this paragraph shall not exceed two thousand dollars per person receiving such retirement benefits and this limitation shall apply to all returns or amended returns filed after the last day of December, one thousand nine hundred eighty-eight; (1993, c. 156)

W.Va. Code § 11-21-12(c)(6) (1991 & Supp. 1994)

(c) *Modifications reducing federal adjusted gross income.*—There shall be subtracted from federal adjusted gross income to the extent included therein:

* * *

(6) Retirement income received in the form of pensions and annuities after the thirty-first day of December, one thousand nine hundred seventy-nine, under any West Virginia police, West Virginia firemen's retirement system or the West Virginia department of public safety death, disability and retirement fund, including any survivorship annuities derived therefrom, to the extent includible in gross income for federal income tax purposes; (1993, c. 156)